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STATE REGULATION OF CORPORATE PROFITS.

AT the time when the Federal Constitution was adopted, municipal government in America was a very simple affair, and was managed with ease and economy through local officers, who provided for the making and repairing of roads, looked after disorderly characters, abated local nuisances, and levied rates for the few and simple public needs. When the growing population of a particular locality appeared to need larger powers of local government, the legislature granted them, but they often involved little more than the holding of fairs as a means of building up local trade, the institution of a local court for the trial of petty cases, a few simple precautions against fires, the employment of watchmen, provision for the streets, and authority to levy taxes under very narrow restrictions to meet the corporate expenses for these purposes. State government was more complicated, but it was vastly less so than it has since become.

Changes, the most of which have taken place within fifty years, have made everything different. The railroad has come, for good and for evil, and has displaced not only the old stage-coach, but to a large extent also the use for trade and travel of the common roads. The State and its municipalities provide the common highway and keep it in repair, and it seems there-

fore to be within their authority if not their duty, now that the railway has become the chief convenience of travel and transportation, to provide that also. The use of coal gas has become common for illuminating purposes, and the proper police of all urban communities requires that the authorities should provide it, or something equivalent or better, for public streets and places. The telegraph and the telephone are to some extent superseding the post-office, and are quite as much a public necessity. The advance in sanitary science makes us acquainted with the dangers of imperfect city sewerage, and of impure water, and we are compelled to abandon the town pump, and to bring from a distance an abundant supply of pure water for domestic and public use. We also see the necessity of giving to the city population the opportunity of breathing pure air in parks which are shaded with trees and refreshed with fountains. Here are important public wants, every one of which is expensive, and must be provided for, if at all, at a cost of taxation which to our frugal ancestors would have seemed almost like confiscation.

When a public need is thus discovered or felt, the first question often is, whether it shall be met by the Government directly, and at its own expense, or whether the franchise of providing for it shall be conferred upon individuals, with the privilege of making it a source of profit. The former is the method which apparently is most consistent with republican institutions, for it grants no favors, and does not complicate individual with governmental affairs. But in practice it is found subject to very serious objections. We know what some of these are, for they have been confronting us for many years, and subjecting us sometimes to disaster and disgrace. The cost leads to great debts, and these are commonly great calamities. The management of railways, lighting works, the telegraph, or the telephone is a business, requiring in those who take it up not only a scientific preparation and training, but also the same attention, care, prudence, economy, and circumspection which in any private business are the requisites of success. Whether in the hands of a municipality such a business will be subjected to the proper management must depend, directly or remotely, upon the annual elections. These, when honestly conducted, with exclusive regard to the proper municipal issues, are by no means certain to bring to the front men of business energy and capacity, and when they do, are not sure to put them in the places most suited

to their abilities. But when municipal elections are, as now, conducted upon national issues, with which they have no concern whatever, we may take it for granted that the majority of those who seek and obtain the offices will not be men distinguished for their business qualities, or who have been found successful in the management of their own affairs. The public works of states and cities are, therefore, likely to fall into the hands of those who will not manage them with skill or with high business capacity. But what is worse is, that so long as the practice continues of making municipal offices and places the spoils of party warfare, it must be expected, and will certainly happen, that the dominant party or its local leaders will manage from the control of public works to derive profits for themselves at the expense of the community. There seems, therefore, to be strong if not controlling reasons, whenever the supply of a public convenience can assume the form of a private and continuous business, for permitting it to take that form, and for granting to individuals the necessary franchise for the purpose.

But to grant such a franchise is to give a special privilege which presumably has pecuniary value. It is therefore to prefer some citizens, who are made the recipients of the grant, over citizens in general; and though this is unavoidable, it is in a sense invidious. In many cases also, the privilege from its nature must be exclusive; and we are to have persons carrying on a business as a public agency, with the public as a customer, but without the competition which, in the case of ordinary business, is supposed to be the sole protection against extortionate demands. We thus have the odious features of monopoly, as the result of a grant of a public privilege; and this will be obnoxious in proportion to the opportunity it gives for unjust exactions, and to the neglect on the part of the State to provide against them.

But suppose the State, when granting the privilege, makes no provision against an extortionate use of it for the purposes of private gain, is it powerless to do so afterward? No question more important than this has hitherto demanded the attention of the country. If the State may grant irrepealable and unchangeable franchises of all sorts, we may find, after a few years of foolish or corrupt rule, that it has bartered away a large part of its ability to be useful to the people, and that, instead of existing for the equal and common good of all, it has built up privileged classes to whom the functions of government have

been granted or pledged. It would be easy to imagine a state of things that might become intolerable.

When the force, effect, or binding nature of a public grant, and especially of a corporate grant, is in question, we turn spontaneously to the Dartmouth College case for the light and the law that must guide and govern us. That case has tended to fix in the public mind the impression that whatever can be obtained in the form of a legislative grant has a property character affixed to it, which entitles it to common protection with the earnings of industry and the legitimate accumulations of capital, and that it also has something of the sacredness supposed to inhere in public compacts and treaties, and must be specially guarded for that reason. The decision has been extolled beyond measure for its preëminent wisdom and beneficence; and it has been assumed that without it the protection of contracts would have been impossible, and especially that the prodigious results of corporate organization, which has done so much to enrich and improve the country, could never have been attained. But if the Dartmouth College case brought blessings, it also created alarm; the corporations protected by it acquired a greatness, wealth, and power which the political instincts of the people made them distrust and fear; and in recent constitution making they have given distinct expression to the belief that a legislature with authority to tamper with corporate powers is less to be feared than a legislature with authority to grant irrepealable franchises and privileges. The revised State constitutions of recent date have therefore taken from the legislative department the power to grant corporate charters, except subject to the unalterable condition, as a part of the contract, that the charter may be altered or repealed in the legislative discretion; and that condition, in the case of nearly all recent corporations, is a part of the law of their being. It has been imposed under the influence of a fear that without it not only were corporations likely to become too powerful for effectual control, but also that the State was in danger of stripping itself for their benefit of essential powers.

There are still some charters, however, that, having been granted without the condition, are not subject to repeal or amendment at the legislative will; there are also important franchises in the hands of unincorporated persons. And in examining the State power to regulate charges, it seems necessary to consider it, first, as it would exist at the common law; second,

under charters not repealable or amendable; and, third, under charters which are subject to legislative control.

First. Of the corporations serving public ends, the most important are railways. These are chartered that they may establish the business of carrying for hire the property and the persons of those who may desire that service. This is a business well known to the common law, and has long been recognized as having a semi-public character which made it an exception to private business in general. The law permitted persons to assume the character of common carriers only upon certain conditions; one of which was that they should carry impartially for all persons. Another condition was that they should carry property at reasonable rates;* and, in the absence of special bargain, the law, when necessary, undertook to determine what might be reasonable rates under the circumstances. But, subject to these and a few other conditions, any one might offer his services as a public carrier; he needed no State permission for the purpose. And no doubt he might build a railroad and operate it in his business, if he could purchase for his track a right of way; but he would operate it under the same common law conditions which other public carriers must observe. He would therefore be under the restriction that his charges should be reasonable.

But legislative permission to build and operate a railroad is commonly a necessary requisite. Highways must be crossed and public places intersected or occupied; and a railroad upon any of these, without permission of the State, would be a public nuisance, and subject as such to indictment and removal. It becomes necessary also to resort to the eminent domain to force sales of lands for a right of way by persons who will not voluntarily part with them or who take advantage of the circumstances to demand exorbitant prices. But, in addition to other impediments to individual construction, the capital required for the purpose is so great that only the coöperation of many persons can secure it; and the safe and convenient method of coöperation is under corporate forms. We therefore, of necessity, have charters for railway companies.

* Harris *v.* Packwood, 3 Taunton, 264; Oppenheim *v.* Russell, 3 Bos. and Pul. 42; Ashmole *v.* Wainwright, 2 Q. B. 837; Fitchburg R. Co. *v.* Gage, 12 Gray, 395; McDuffee *v.* Railroad Co. 52 N. H. 430; Johnston *v.* Railroad Co. 16 Fla. 623; Holford *v.* Adams, 2 Duer, 471; Streeter *v.* Railroad Co. 45 Wis. 383.

If these companies received from the State nothing beyond the franchise to be a corporation for operating a railway, they would, when formed, become merely carriers of goods and persons under common law rules; and we need look no further to ascertain their duties and obligations. But they receive from the State many other franchises and privileges. They are permitted, as has been said, to have the aid of the eminent domain, and to occupy public streets and places. Sometimes they are favored in the matter of taxation; sometimes the power to tax is employed to aid them; and always there are exceptional rules of police for their convenience and protection. All these are special favors which they receive from the State to enable them to set up and carry on with profit their business as common carriers; and the inducement—if not the right—to grant them must be found in the fact that they are created to subserve public ends. It is quite certain that they could be given power to interfere with private property on no other ground whatever.

We have, then, railway companies existing as common carriers, and subject to the common law obligation to make only reasonable charges. But what are reasonable charges? Reasonable prices in general are such prices as are determined by demand and competition; and they do not necessarily lose their character as reasonable, because, under the pressure of demand and in the absence of competition, they become very profitable. If, therefore, a railway corporation is to be regarded as occupying in all respects the position of a common law carrier, large profits will not necessarily determine its charges to be unreasonable. But when the company receives from the State special privileges and grants of power, on the understanding that these are conferred in the public interest and to subserve public ends, it is not by any means certain that its profits may not justly be used as a test of the reasonableness of its charges. The charter is granted for the mutual benefit of the State and the corporators; and, while it contemplates reasonable returns to the latter on their investment, it cannot fairly be understood to contemplate anything more. In determining what are such returns, all the risks to which the investment is subject are to be taken into the account; and it is obvious that these are much greater than the risks which attend the loaning of money on security. But charges can only be regulated for the future; and this must necessarily be done, either by the company itself or by the State,

upon estimates of the business likely to be done and its cost. That the company could not be exclusive judge in doing this even at the common law has already been seen; and as no third power can intervene except by mutual consent, it seems to follow of necessity that the State may limit profits as well as charges. The judicial decisions go to this extent, that when the State establishes a maximum of charges, these charges are to be deemed, *primâ facie*, at least, reasonable.*

The case of corporations which are created to serve public ends, in new ways and by means of new inventions and discoveries, differs from that of railroad companies in this, that their business being new, duties and obligations of exceptional character have not been prescribed for them by the common law. A telegraph company, for example, is not a common carrier, and therefore does not come under the rules which control the carrier's business. But there is precisely the same reason why the State should regulate its business and keep its charges within the limits of reason that applies to the business of railways. The telegraph exists only by permission of the State, and is only constructed by the aid of the eminent domain. The main object in granting the aid is to promote the public convenience and welfare, by means of the telegraph as a public agency; but incidentally and as a consideration for its service to the public, the company is expected to make a profit for its members. If the charges that are to produce this profit may be imposed at discretion, the State is at the mercy of the agent it has created; the main purpose is subordinated to the incidental. There can never be any implication that this was the intention in any grant for a public purpose. A fair and reasonable use of the grant must always be understood; and obviously what the public shall pay for the conveniences which the grant secures for it is matter of the highest moment. It is just as much within the proper police authority of the State to keep a telegraph company from abusing its powers in the matter of charges as it is to prevent other abuses. And this may be done in strict accord with the principles of the common law, and by virtue of powers which are inherent in every sovereignty.

* The Granger Cases, 94 U. S. Reports, 155, 164, 179, 180, 181; Shields *v.* Ohio, 95 U. S. Reports, 319. As to the elements of reasonable charges, see Pickford *v.* Grand Junction R. Co. 10 Mee. & W. 399.

Second. Where charters exist which have been granted without the reservation of the power to amend or repeal, the State must abide by the grant, and if it was improvident, must suffer the consequences. All that can be done is to see that the incorporators themselves observe the conditions of the charter according to its true intent, and if they fail to do so, to forfeit it. This is the rule of constitutional law, and it is also the rule of public honor and integrity.

Charters, however, are not often their own sufficient interpreters; and the question of construction in respect to the power to make charges and accumulate profits is often troublesome. The grant of this power is sometimes subject to a maximum limit; and, when that is the case, nothing which observes the limit can be deemed abuse. But more often the grant is either silent on the subject of charges — in which case the corporation by implication would be empowered to fix them — or it gives the power to the corporation in general terms, and prescribes no maximum. In the first of these cases, the right of the State to restrict corporate charges is unquestionable. In the second, though long and earnestly contested, it is now well settled. The ground on which it is affirmed is, that the State, in conferring upon the corporation the right to charge for the services rendered to the public, without expressly abdicating the power of control, must be understood to have reserved it. All corporate grants are to be strictly construed, and it must always be assumed that the State proposed to give nothing which it has not given in express terms, and that the grantees have bargained for and secured in express terms everything they understood they were to have. A railroad charter, therefore, which authorizes the company to establish such rates for the conveyance of persons and property as it shall from time to time determine by its by-laws, confers the power subject to the higher authority in the State to regulate the rates itself if the circumstances shall seem to demand its interposition.*

It may become a question at some future time whether an express grant to a corporation of the exclusive right to fix its own charges is not subject, like all other corporate franchises, to the implied condition that it shall not be abused. The penalty for the abuse of franchises is forfeiture by judicial proceeding

* Ruggles *v.* People, 91 Ill., 256, recently affirmed in the Federal Supreme Court; Shields *v.* Ohio, 95 U. S. Rep. 319.

at the instance of the State; and it is conceivable that cases of such outrageous extortion and palpable injustice might occur as would justly subject a corporation to this punishment. But the remedy being severe would be applicable in extreme cases only.

Third. Whenever, in granting corporate franchises, the power to amend or repeal at will has been reserved, the control of the State must be deemed practically absolute. It is of no importance that the charter confers upon the corporation the exclusive authority to fix its own charges, for the legislature may at any time revoke the grant or set limits to it. The corporators have accepted it with the distinct understanding that they have only an estate at will in their franchises, and have consented to assume all risks of State power being exercised prejudicially. No contract is therefore violated and no faith broken when the State asserts its authority.*

It may nevertheless be a great hardship, and it may be fall the corporation as well when it is blameless as when it is criminal. If corporate powers are taken away on judicial forfeiture, the judgment determines that there has been corporate misconduct deserving it; but when the legislature acts under its reserved power, it is not necessarily to be inferred that any corporate misbehavior exists or is charged. Corporate franchises are granted on considerations of State policy, and they may be taken away upon no other reason than that the legislative view of State policy has changed. At one period, we deem it wise to create State banks of issue; at another, we look upon them as needless, and proceed to legislate them out of existence, even though we make against them no complaint of failure in duty. The reason is that we have discovered a better way.

But what is the effect of the repeal of a corporate charter? The franchise to be a corporation is gone, of course, but corporate property remains. If the corporation was a water supply company, there are the buildings and machinery, the pipes in the ground, the hydrants, etc.; if it was a railroad company, there are the rolling stock, the stations, the machine shops, and the track. In either case, what is permanently under or upon the ground,

* McLaren *v.* Pennington, 1 Paige, 102; Crease *v.* Babcock, 23 Pick. 334; Miners' Bank *v.* United States, 1 Greene (Iowa), 553; Railroad Co. *v.* Sharp, 5 Harr. (Del.) 454; The Granger Cases, 94 U. S. Rep.; Shields *v.* Ohio, 95 U. S. Rep. 319.

and valuable chiefly for use where it is, is likely to be of far greater value than that which is movable and which can be sold for use elsewhere. The corporation while in existence acquired the property and the right to use it where it has been placed; and any legislation which takes away the right to use it there according to the intent is practical confiscation. Nobody now disputes that the corporators, when their charter is taken away, retain their property, or that it may be subjected to the payment of corporate debts; but when the chief property value consists in the right to use what they have where it has been permanently placed, if the corporators can neither as tenants in common nor in any other capacity any longer use it themselves, or sell it to others for use, we shall be within bounds if we say that there are now within the United States several billion dollars' worth of corporate property, which, as against the action of legislative majorities, has no constitutional protection whatever. Even an amendment of corporate charters, by reducing rates below the cost of service, might be practical annihilation, and destroy not only the value of the stock but the means of paying corporate debts. This may in some cases be a necessary result of unfriendly legislation under the corporate system we have consented to adopt; but it must be conceded that there are serious evils in having any part of the property within the State with no protection but such as may be found in popular favor toward those who own it.

Chief-Justice Shaw said, in one case, that "Where, under power in a charter, rights have been acquired and become vested, no amendment or alteration of the charter can take away the property or rights which have become vested under a legitimate exercise of the powers granted."* He did not profess to decide the case then before him on this principle, though he held an amendment unwarranted which was made under full reservation of power. Afterward, in an opinion by his successor in the same court, it was decided that, while the legislature might, under its power to amend, authorize a corporation to undertake new and additional enterprises of a nature similar to those embraced within the original grant of power, if the act was accepted by a majority of the stockholders in the manner provided by law, it could have no such power without the acceptance, because the effect would be to alter the charter

* Commonwealth *v.* Essex Co. 13 Gray, 239, 253.

contract between the corporation and its members.* Possibly these are to be taken as indications that, even when the power of control is reserved in the broadest terms, the courts must, if possible, find some means of reconciling radical changes or repeals with the fundamental rules of right and justice.†

It ought to be said, however, that much of the legislation which would prove injurious to corporations has right and justice distinctly in contemplation, and is promoted in the sincere belief that the public good requires it. If mischief results from its adoption, it must be attributed to error in judgment or misinformation on the part of those who enacted it. Propositions to regulate the charges of railroad companies are likely to be of this sort. Legislators are likely to think just regulation easy and simple, and in the case of passenger traffic it may be found to be so; but the charges for the transportation of property are governed by conditions which no legislation can possibly change or control, and which railroad companies must observe whatever the statute may say. The law of competition in a country politically divided like ours is an imperious and exacting master; and statutes at most can only modify its operation, while pools at most can only prevent its operating disastrously. What is a fatal impediment to its control by law is, that the States and the nation have, in respect to it, a divided power; and while it is for the interest of the nation at large to encourage the competition which favors long hauls, it is for the interest of localities to make competition most active in short hauls. A State is therefore likely to favor legislation which compels proportional charges, or something near such charges, for all distances; but this, if it could be adopted and enforced, would preclude the great through lines of New York and Pennsylvania from competing at Chicago, St. Paul, and St. Louis in the grain-carrying trade of the Northwest, and would reduce such links as are wholly within a State, to the condition of mere local roads, compelled to make high charges or go into bankruptcy. But whenever State power should thus be exerted prejudicially, it can hardly be doubted that Congress would interfere, under its authority over inter-State commerce, in aid of those competitive forces which

* Durfee *v.* Railroad Co. 5 Allen, 230.

† See Shields *v.* Ohio, 95 U. S. Rep. 324; Sinking Fund cases, 99 U. S. Rep. 700; San Mateo County *v.* Railroad Co., decided at the Circuit by Mr. Justice Field, and now awaiting decision in the Federal Supreme Court.

silently but steadily have forced down the charges for railway service.*

It is not alone in the matter of railway regulation that law-making is likely to be ill-advised and detrimental to both public and private interests. The supply of public conveniences to cities is commonly a monopoly, and the protection of the public against excessive charges is to be found, first, in the fact that low prices generally extend the market, and, second, in the municipal power of control. Except in very large cities, public policy requires that for supplying light or water there should be but one corporation, because one can perform the service at less rates than two or more, and, in the long run, will be certain to do so. But scheming men make periodical attacks upon corporations existing for these and similar purposes, and with a popular cry for their watchword, they can always enlist local interest in their favor. If they succeed in obtaining a rival franchise, the subsequent history is commonly this: a war of rates for a season, and then either a sale of one franchise to the owners of the other, or a division of the territory, or an agreement upon charges. The final result is that the two supply the market at a greater cost than the one, and the additional cost is paid by the public. Whoever expects that a destructive competition is to be continued indefinitely must have a faith in the integrity and public virtue of local boards which experience scarcely justifies. The legislation which exposes a great property, invested in a public enterprise, to disastrous risks offers a direct temptation to irregular and crooked proceedings. If men solicit from a city council a franchise which they cannot legitimately make profitable, it is a natural inference that they propose either to use it as trading property or in some way to find their profit in the manipulation of future councils.

The true policy of the State is to give due and full protection to corporate property, and at the same time to insist on the

* In 1870, the average rate per mile for the transportation of a ton of freight over seven great lines of road radiating from Chicago was 2.227 cents. In 1880, it had come down by steady reduction to 1.090. On the Michigan Central, whose freights have been unaffected by legislation, the average charge for moving a ton of freight thirty miles is now about the same as the twenty-five cents which one expects to pay a truckman for moving a box of goods from one street to the next. There are roads in the country whose charters permit a charge of five cents per mile for passengers, but the exigencies of the business compel their managers to accept three.

faithful performance of corporate duties. It is no more for its interest to invite and encourage raids on corporations than it is to countenance vast corporate profits for which no adequate return is made. In some kinds of business competition will keep corporations within the limits of reason in their charges; in others it will not. When it will not, it may become necessary to legislate upon profits. If the business is simple, like the supply of light or water, this can be done by prescribing a tariff of rates; but sometimes a tariff of rates prescribed by law could only be mischievous. It would generally be so in railroad transportation of property, except in the case of mere local roads. Rates must yield and accommodate themselves to innumerable circumstances and contingencies, expected and unexpected; and these must be met and provided for by the governing power as they arise. No other known business requires larger technical skill, greater ability, or wider experience. And the ablest, wisest, and most experienced man would be guilty of an act of supreme folly, if, with ample power, he undertook to prescribe unbending rules for future charges. To prescribe tariffs of rates for one road, or the roads of one State, which the competitors are not obliged to observe, would be like prescribing in advance by law the movements of an army, while the enemy was at liberty to maneuver at discretion. Railroad competition is an earnest strife, if not a warfare; and experience hitherto has shown that all that can be done by common arrangements and understandings is simply to prevent the strife becoming mutually destructive.

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